**FEDERAL COMMUNICATIONS COMMISSION**
**Washington, D.C. 20554**

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| In the Matter of | ) | |
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| Multi-Association Group (MAG) Plan for Regulation of Interstate Services of Non-Price Cap Incumbent Local Exchange Carriers and Interexchange Carriers | ) | CC Docket No. 00-256 |
| | ) | |
| Federal State Joint Board on Universal Service | ) | CC Docket No. 96-45 |
| | ) | |
| Access Charge Reform for Incumbent Local Exchange Carriers Subject to Rate-of-Return Regulation | ) | CC Docket No. 98-77 |
| | ) | |
| Prescribing the Authorized Rate of Return for Interstate Services of Local Exchange Carriers | ) | CC Docket No. 98-166 |

# NATIONAL TELEPHONE COOPERATIVE ASSOCIATION INITIAL COMMENTS

L. Marie Guillory
Daniel Mitchell
Jill Canfield

4121 Wilson Boulevard
10th Floor
Arlington, VA 22203

February 14, 2002

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## SUMMARY

Optionality must be an essential component of any incentive regulation plan that the Commission may adopt in this proceeding. Determining a single alternative regulation plan that establishes the proper incentives for more than 1300 diverse rate-of-return (ROR) carriers spread throughout all regions of the United States will be extremely difficult, if not an impossible, to accomplish. Today rural carriers are faced with daunting task of confronting competition from a variety of competitors using various technologies, including wireless carriers, cable companies, Internet service providers, high-speed data carriers, and state-run telecommunications providers. Mandatory incentive regulation provides no guarantee that rural consumer will be better off. ROR regulation for many years has served rural consumers well and has achieved the goals of the Act. It has provided rural consumers with competitive, affordable, high-quality telecommunications services that are comparable, and in some instances better, than their urban counterparts. The Commission should therefore act prudently and allow ROR carriers the option of maintaining rate-of-return regulation and the ability to choose the exact time when, if at all, to transition into any new alternative regulation plan.

There is no need to merge LTS with ICLS. The merger will not serve any of the purposes that the Commission contemplates and is likely to diminish the viability of the NECA common line pool. The pool is beneficial to the hundreds of small rural ILECs that participate. Companies that are not in the pools will not be adversely affected by maintaining LTS in the common line pool. They will continue to recover their common line revenue requirements from SLCs and ICLS. Merger of LTS with ICLS, on the other hand, will threaten the viability of the pools and deprive the administrative benefits of

pooling to smaller companies that rely on the pools. It is not in the public interest to merge LTS with ICLS.

The all-or-nothing rule should not apply to single study area ROR carriers and multi-study area ROR carriers seeking to keep all of their exchanges and study areas regulated under rate-of-return regulation. NTCA member rural telephone companies do not acquire entire study areas from other carriers. They acquire neighboring exchanges in the rural areas of large ILEC study areas and then seek a waiver from price cap regulation to include the acquired exchanges into their rate-of-return regulated study area. The reasons for having the rule simple do not apply to these carriers.

The Commission should also not require some level of competition before pricing flexibility is permitted. Any competition threshold is too high. The relief in the form of additional pricing flexibility should be granted immediately upon adoption of an order in this proceeding. Unlike large, price-cap carriers, rate of return carriers are vulnerable at any level of competition. ROR carriers must therefore have pricing flexibility in anticipation of competition.

To provide consumers in rural regions of the Nation with access to affordable services and ensure competitive neutrality the Commission should: (1) make any incentive regulation plan adopted in this proceeding fully optional for all ROR carriers; (2) suspend the merger of long term support (LTS) into interstate common line support (ICLS), (3) suspend the application of the ICLS portability rules; (4) review and revise the definition of competitive neutrality; (5) eliminate the all-or-nothing rule for single study area ROR carriers seeking to keep all of their exchanges and study areas regulated under ROR regulation; and (6) allow ROR carriers additional pricing flexibility.

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**NATIONAL TELEPHONE COOPERATIVE ASSOCIATION**
**INITIAL COMMENTS**

The National Telephone Cooperative Association (NTCA)[1] hereby files its comments in response to the Federal Communications Commission's (Commission's or FCC's) Further Notice of Proposed Rulemaking (FNPRM) in the above-captioned proceeding.[2] NTCA specifically requests that if the FCC adopts an incentive regulation plan for rate-of-return (ROR) carriers, the plan be fully optional for all ROR carriers. NTCA also requests that Commission keep long-term support (LTS) in the common line

[1] NTCA is a non-profit corporation established in 1954 and represents 545 rate-of-return regulated rural telecommunications companies. NTCA members are full service telecommunications carriers providing local, wireless, cable, Internet, satellite and long distance services to their communities. All NTCA members are small carriers that are defined as "rural telephone companies" in the Telecommunications Act of 1996 (Act). They are dedicated to providing competitive modern telecommunications services and ensuring the economic future of their rural communities.
[2] *In the Matter of the Multi-Group (MAG) Plan for regulation of Interstate Services of Non-Price Cap Incumbent Local Exchange Carriers and Interexchange Carriers* CC Docket 00-256, *Federal-State Joint Board on Universal service CC Docket* 96-45, *Access Charge Reform for Incumbent Local Exchange Carriers Subject to Rate of Return Regulation* CC Docket No. 98-77, and *Prescribing the Authorized Rate*

pool, eliminate the all-or-nothing rule and allow ROR carriers additional pricing flexibility.

## I. AN INCENTIVE REGULATION PLAN MUST BE FULLY OPTIONAL FOR ALL ROR CARRIERS

Optionality must be an essential component of any incentive regulation plan that the Commission adopts in this proceeding.[3] Determining a single alternative regulation plan that establishes the proper incentives for more than 1300 diverse ROR carriers spread throughout all regions of the United States will be extremely difficult, if not impossible. Considering an incentive regulation plan for these carriers must therefore be done with great care, deliberation and flexibility. If done incorrectly, service to consumers living in small rural communities may suffer substantially.

No single incentive plan will work for all ROR carriers. NTCA represents 550 rural incumbent local exchange carriers (ILECs) with customer bases ranging from less than 100 to more than 50,000. Half of these rural ILECs have less than 2500 subscribers. Eighty percent serve between 500 and 10,000 subscribers. Each company is unique and serves communities and markets that are also unique, such as the remote woodlands in Maine and New Hampshire, small farming communities in Kansas, Iowa, Nebraska, and the Northern Plains states, insular fishing towns in Alaska, and small desert communities in Arizona, New Mexico, Texas, and Nevada. The diversity among these carriers with their varying operating conditions and their lack of economies of scale warrant that any

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*of Return for Interstate Services for Local Exchange Carriers* CC 98-166, FCC 01-304, (rel. November 8, 2001).

[3] Optionality must include a carrier's free choice to transition into an alternative regulation plan, as well as the carrier's choice to remain under rate-of-return regulation as a cost company, an average schedule company, and a tariff filing company under Parts 61 and 69 of the Commission's rules.

incentive regulation plan established for ROR carriers must be fully optional.[4] Carriers must also have unilateral control over the timing to opt into any incentive regulation plan that the Commission may adopt.

US West's (now Qwest's) reaction to a mandatory one size fits all price cap incentive regulation plan demonstrates why optionality is so important for rural ROR carriers. The incentives under price cap regulation apparently were not enough for Qwest to maintain, upgrade, and enhance service in many of its high-cost rural exchanges. In 1999, the company sold nearly 600 rural exchanges in 14 states.[5] Many of these exchanges were purchased by smaller, rural telephone companies operating under rate-of-return regulation. Just recently, Qwest announced its intention to shed yet more rural exchanges.[6]

Since the early 20th century AT&T, the Bell Operating Companies (BOCs) and GTE chose not to invest in facilities to provide basic telephone service to nearly 40 percent of the geographic area of the United States. The sparse populations and difficult landscapes in these areas were simply too costly for these large carriers to invest in and the risk of not recovering their investment was too high. Many Americans living in these areas had no choice but to invest their own time, money and resources to form small subscriber-owned telephone cooperatives and commercial telephone companies to build and maintain telephone systems to serve their communities. These companies have become the small rural ILECs of today. During the second half of the 20th century, rate-

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[4] *Community Based Telephone Service for Rural America,* The NTCA 21st Century White Paper Series, by NTCA Staff, (First White Paper in a series of four) (May 2000).
[5] *US West sells rural exchanges so they'll get better service,* The Business Journal of Phoenix (August 9, 1999).
[6] TR Daily, January 29, 2002.

of-return regulation has helped these companies grow and meet the goals of the Act by providing quality, reliable and affordable telecommunications services to rural America. It is this regulatory system that has worked and served rural America well for more than 40 years.

The NECA pooling structure has also worked well for two decades. The pooling system has reduced administrative costs, created incentives and spread the risks in a way that have not only enhanced telephone service, but also helped bring substantial economic value to these rural communities. NTCA sees no reason why the pooling structure could not be adapted to accommodate an optional incentive regulation plan for rate-of-return carriers. It is NTCA's understanding that NECA has the capabilities to revise its pooling procedures to facilitate any meaningful incentive regulation plan for pool members. Revised procedures would not require ROR carriers to leave the pool to avail themselves to an alternative regulation plan. Further, revised procedures could address any potential issues created if a ROR carrier is in the common line pool and not the traffic sensitive pool.

Increased competition for basic and advanced services from new entrants in rural areas is providing the adequate incentives for investment in many rural markets. Competition in rural America ten years ago is strikingly different from what it is today. Today rural carriers are faced with the daunting task of confronting competition from a variety of competitors that use various technologies. These include wireless carriers, cable companies, Internet service providers, high-speed data carriers, and state-run telecommunications providers. In today's competitive rural markets the long-held belief that rate-of-return regulation promotes inefficiency is not necessarily true. Rate-of-return calculations will play a much lesser role, as rural carriers must constantly examine prospective investments in terms of meeting the continually increasing competitive challenges.

"If it's not broken, don't fix it." Mandatory incentive regulation provides no guarantee that rural consumers will be better off. Rate-of-return regulation has served rural consumers well and has achieved the goals of the Act. It has provided rural consumers with competitive, affordable, high-quality telecommunications services that are comparable, and in some instances better, than their urban counterparts. The Commission should therefore act prudently and allow ROR carriers the option of maintaining rate-of-return regulation and the ability to choose the exact time when, if at all, to transition into a new alternative regulation plan.

Lastly, any transition into incentive regulation should not be conditioned on the waiver of carrier's rural exemption under section 251(f). Section 251(f)(1)(A) provides rural telephone companies[7] with a statutory exemption from all Section 251(c) duties and obligations, including those that relate to the provision of unbundled network elements, interconnection and collocation. This exemption is effective until a state commission has decided pursuant to Section 251(f)(1)(B) to terminate the exemption. Neither the FCC nor a state commission (without a bona fide request for interconnection, services, or network elements) can unilaterally terminate a rural telephone company=s section 251(f)

[7] *See* 47 U.S.C. § 153 (37) for the definition of a "rural telephone company."

exemption from the obligations of section 251(c), which would include any new obligations or requirements under an alternative regulation plan.[8]

## II. THE FCC SHOULD KEEP LONG TERM SUPPORT IN THE COMMON LINE POOL

There is no need to merge LTS with ICLS. The merger will not serve any of the purposes that the Commission contemplates and is likely to diminish the viability of the NECA common line pool. The pool benefits the hundreds of small rural ILECs that participate in it.

Low-cost companies that remain in the pool have several options for filing rates that may closely reflect costs, including banded EUCL rates. The Commission's revised rules also permit NECA to file EUCL rates that are deaveraged below the study area level, further accommodating companies with lower than average common line costs. Those companies that chose not to participate in the NECA end user tariff can also file their own end user rates while remaining in the pool. Thus, low-cost companies have several options for filing rates that more closely reflect costs without any need to revise rules on LTS eligibility. Merger of LTS with ICLS, on the other hand, will threaten the viability of the pools and deprive the administrative benefits of pooling to smaller companies that rely on the pools. It is not in the public interest to merge LTS with ICLS.

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[8] *See In the Matter of Deployment of Wireline Services Offering Advanced Telecommunications Capability,* CC Docket No. 98-147 and *Implementation of the Local Competition Provisions of the Telecommunications Act of 1996,* CC Docket No. 96-98, Third Report and Order on Reconsideration in CC Docket No. 98-147, Fourth Report and Order in CC Docket No. 96-98, Third Further Notice of Proposed Rulemaking in CC Docket No. 98-147, and Sixth Further Notice of Proposed Rulemaking in CC Docket No. 96-98, && 38-41, FCC 01-26 (rel. January 19, 2001)("We clarify that no state commission can terminate a rural telephone company's section 251(f)(1) exemption from the obligations of section 251(c), including the Commission's line sharing obligation, absent a bona fide request for interconnection, services, or other network elements that the state commission determines is not unduly economically burdensome, is technically feasible, and consistent with section 254.")

## III. THE ALL-OR-NOTHING RULE SHOULD BE ELIMINATED FOR ALL SINGLE STUDY AREA ROR CARRIERS AND MULTI-STUDY AREA ROR CARRIERS SEEKING TO KEEP ALL THEIR STUDY AREAS UNDER RATE-OF RETUN REGULATION.

The all-or-nothing rule should not apply to single study area ROR carriers and multi-study area ROR carriers seeking to keep all of their exchanges and study areas regulated under rate-of-return regulation.[9] NTCA member rural telephone companies do not acquire entire study areas from other carriers. They acquire neighboring exchanges in the rural areas of large ILEC study areas and then seek a waiver from price cap regulation to include the acquired exchanges into their rate-of-return regulated study area. The reasons for having the all-or-nothing rule simple do not apply to these rural carriers.

The purpose of the all-or-nothing rule is to prevent a carrier from shifting costs from its price cap affiliate to its ROR return affiliate, which would allow the ROR affiliate to charge higher prices than otherwise possible to recover in its higher revenue requirement (because of increased costs), while at the same time, increasing profits of the price cap affiliate as a result of cost savings. Also, the rule seeks to prevent carriers from gaming the system by switching back and forth between ROR regulation and price cap regulation. According to the FCC, the switching costs back and forth allows a price cap carrier to increase earnings by opting out of price cap regulation, build a larger rate base under ROR regulation in order to raise rates, and then cut costs back to efficient levels after returning back to price cap regulation.

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[9] The all-or-nothing rule requires that when a ROR carrier purchases an exchange from a price cap carrier it must convert to price cap regulation within one year or seek a waiver of the all-or-nothing rule. 47 C.F.R. § 61.41(c)(1).

Since single study ROR carriers and multi-study area ROR carriers seeking to keep all study areas under rate-of-return regulation would not be operating separate affiliates under two different types of regulation, the potential for gaming the system or shifting costs between ROR and price cap affiliates is non-existent. The all-or-nothing rule therefore serves no legitimate purpose when applied to these companies.

The Commission should eliminate the all-or-nothing rule or exempt ROR carriers seeking to keep all of their exchanges, new and existing, under rate-of-return regulation, from the rule. The Commission should also no longer require these carriers to bear the cost of filing a waiver petition every time they acquire an exchange. The waiver process is an unnecessary and costly burden. Instead, rural telephone companies should be allowed to file a letter with the FCC after the purchase of a new exchange or exchanges indicating that it will include the new exchanges in its existing study area and operate all exchanges under rate-of-return regulation. Eliminating the waiver process and allowing rural ROR carriers to file a letter will reduce carrier costs and relieve the Commission of the administrative burdens associated with processing waiver requests, while ensuring that carriers are not shifting costs or gaming the system.

## IV. THE FCC SHOULD ALLOW ROR CARRIERS ADDITIONAL PRICING FLEXIBILITY

The Commission correctly recognizes that many rate-of-return carriers will face competition, albeit some sooner than others. In order for these rural ILECs to compete with the unregulated new entrants and respond to competitive pressures while maintaining affordable end user rates, the Commission must provide them with significant pricing flexibility.

Without pricing flexibility, rural ILEC customers will migrate to competitors because of regulatory burdens and associated costs, rather than because of the competitors' greater efficiency or customer service. The migration of individual large volume customers could be devastating for a rural telephone company and the community it serves. Rural carriers are often reliant on a few large users for the bulk of their revenues. Rural areas usually have only a few main users of telecommunications service in the community, often just one or two larger employers. Understandably, these large volume users are competitive targets. However, the loss of one large customer, especially if due to regulatory constraints, may signal the downfall of a small carrier or cause the rest of a community's end user rates to skyrocket to unaffordable levels. The Commission should therefore provide rate-of-return carriers with additional pricing flexibility to deaverage prices within study areas, offer volume and term discounts and enter into individual contract pricing arrangements with customers at the time when it best fits their individual competitive circumstances.

The Commission should not require some level of competition before pricing flexibility is permitted. Any competition threshold is too high. The relief in the form of additional pricing flexibility should be granted immediately upon adoption of an order in this proceeding. Unlike large, price-cap carriers, rate of return carriers are vulnerable at any level of competition. As stated above, the loss of one large-volume user can have a devastating impact on the small carrier. Rate of return carriers must therefore have flexibility in anticipation of competition. Flexibility in response to competition will be too late.

The Commission should also not require that flexibility be granted upon the existence of a carrier in the service area with eligible telecommunications status, the issuance of a request for proposals by a customer in the rate-of-return carrier's service area, the filing by a rate-of-return carrier of a tariff offering UNEs, or the receipt by a rate-of-return carrier of a request for UNEs. Competitors may enter a rural ILEC service territory and capture a large volume user without ever triggering any of these requirements. They conditions offer no protection to the small, rural carrier and do not meet the Act's requirements of competitively neutral.

The Commission's concerns that rate of return carriers would abuse a pricing flexibility option are unfounded. Rate of return carriers are rate regulated and there exist current accounting procedures and regulatory structures to prevent abuse. Further, a competitor suspecting abuse could file a Section 208 complaint against the offending carrier for any alleged abuse.

Lastly, the Commission requests comment on the impact that permitting pricing flexibility would have on the NECA pooling process. It is NTCA's understanding that pricing flexibility will work within the NECA pool and there is no need for rate of return carriers to leave the pool as a condition of obtaining pricing flexibility.

## V. CONCLUSION

In order to provide consumers in rural regions of the Nation with access to affordable telecommunications services in accordance with section 254 of the Telecommunications Act of 1996 and ensure competitive neutrality the Commission should: (1) make any incentive regulation plan adopted in this proceeding fully optional for all ROR carriers; (2) suspend the merger of LTS into ICLS, (3) suspend the application of the ICLS portability rules; (4) review and revise the definition of competitive neutrality; (5) eliminate the all-or-nothing rule for single study area ROR carriers and multi-study area ROR carriers seeking to keep all of their exchanges and study areas regulated under rate-of-return regulation; and (6) allow ROR carriers additional pricing flexibility.

Respectfully submitted,

NATIONAL TELEPHONE
COOPERATIVE ASSOCIATION

By: /s/ L. Marie Guillory
L. Marie Guillory

By: /s/ Daniel Mitchell
Daniel Mitchell

By: /s/ Jill Canfield
Jill Canfield

Its Attorneys

4121 Wilson Boulevard, 10th Floor
Arlington, VA 22203
(703) 351-2000

February 14, 2002

CERTIFICATE OF SERVICE

I, Gail C. Malloy, certify that a copy of the foregoing Initial Comments of the National Telephone Cooperative Association in CC Docket No. 00-256, FCC 01-304 was served on this 14th of February 2002 by first-class, U.S. Mail, postage prepaid, to the following persons

/s/ Gail C. Malloy
Gail C. Malloy

Chairman Michael Powell
Federal Communications Commission
445 12th Street, SW, Room 8B201
Washington, D.C. 20554

Commissioner Kathleen Q. Abernathy
Federal Communications Commission
445 12th Street, SW, Room 8-A204
Washington D.C. 20554

Commissioner Kevin J. Martin
Federal Communications Commission
445 12th Street, S.W., Room 8-C302
Washington, D.C. 20554

Commissioner Michael J. Copps
Federal Communications Commission
445 12th Street, S.W., Room 8-A302
Washington, D.C. 20554

Qualex International
Portals II
445 12th Street, S.W.
Room CY-B402
Washington, D.C. 20554

William F. Caton Acting Secretary
Federal Communications Commission
445 12th Street, SW, TW-A325
Washington, D.C. 20554